Remarks by Commissioner Curt Hébert
on
Price Caps in New England

Unfortunately, I find it necessary, once again, to dissent in a case involving price caps. I disagree vigorously with the decision of the Commission, in these companion cases, to extend to the New England Power Pool and ISO New England additional authority to continue to limit the prices charged for certain types of electricity services in New England.

Today's orders involve prices charged for services in two distinct electricity markets in New England – the Operating Reserve market and the Operable Capability market. In an earlier order, issued on September 30, 1999, the Commission accepted revisions to NEPOOL Market Rules 10 and 1. Those revisions, in relevant respects, authorized the ISO to impose a cap on prices charged for Operable Capability during periods of capacity shortages. See ISO New England, Inc., 88 FERC ¶ 61,316 (1999). In a subsequent order, issued on November 23, 1999, the Commission accepted revisions to NEPOOL Market Rules 6, 8 and 9. Those revisions, in relevant respects, similarly authorized the ISO to impose a cap on prices charged for Operating Reserves during periods of capacity shortages or emergencies. See ISO New England, Inc. and New England Power Pool, 89 FERC ¶ 61,209 (1999).

In both of its price cap orders, the Commission was clear in its intentions. It was authorizing only "interim" or "temporary" price caps. The price caps were scheduled to expire on December 31, 1999. The Commission selected that year-end date because the ISO committed to file a proposal for a comprehensive redesign of New England markets, correcting perceived market "design flaws", by that date. The Commission indicated both its extreme distaste for temporary price cap band-aids and its preference for structural long-term redesign solutions to perceived design flaws. And the Commission cautioned the ISO that it would entertain requests for price cap extensions only upon a demonstration of "need" by the ISO. 88 FERC at 61,971; 89 FERC at 61,641-42.

In the first of the New England price cap orders (concerning the Operable Capability market), I issued a lengthy dissent. 88 FERC at 61,973-74. I stated my belief that there were no "design flaws" to remedy; normal economic principles of supply and demand produce higher prices (what the Commission calls "strategic bidding") during periods of capacity shortages. I expressed concern that the crutch of price caps would inhibit the ISO from making real reform – by writing better market rules and implementing technological improvements. And I worried that the ISO, lacking the incentive to actually file the market redesign it has long promised, would be reluctant to give up the price caps to which it had become accustomed. Even the most "limited" and "interim" of price ceilings, because of human inertia and entrenched bureaucratic interests, have a tendency to become more permanent in practice.

In the second of the New England price cap orders (concerning the Operating Reserves market), I simply referred back to my earlier New England dissent. 89 FERC at 61,642. I also referred to my dissent in a related order, in which a majority of the Commission authorized the California ISO to extend for an indefinite period of time a previously "limited" duration purchase price cap in various California electricity markets. See California Independent System Operator Corporation, 89 FERC ¶ 61,169 (1999).

With this background, we reach today's companion orders. Unfortunately, the majority today departs from the explicit limitations on price capping authority imposed in earlier orders. And my concerns articulated in earlier dissents have, most unfortunately, materialized.

In the first of today's orders (Docket Nos. ER00-984-000 and ER00-985-000), NEPOOL announces that it is not prepared to file a comprehensive market reform package until, at the earliest, March 31, 2000. This announcement should, of course, come as no surprise. As long as the price caps are in place, neither NEPOOL nor the ISO has any real incentive to make the hard decisions necessary to provide for real market reform. I have no problem, in concept, with allowing NEPOOL and the ISO whatever time they need to get their act together. I do, however, have a real problem with allowing an additional extension when the Commission has tied the lifting of the price caps with the filing of the long-awaited redesign package. [1] As long as price caps are in place, and those caps are tied to the filing of a market redesign package, I would not countenance further delay in making that filing.

Among other things, the first order also allows for termination, at NEPOOL's request, of the Operable Capability market. I have no objection to this voluntary event. I do find perplexing, however, the majority's rationale in support of termination. Today's order finds, slip op. at 8, that the Operable Capability market is a "redundant" market, with little value to consumers, and that capacity available through the "OpCap" market is also available through other markets. If so, I fail to understand why an artificial cap on prices charged in the "OpCap" market was necessary in the first instance. Moreover, the decision to terminate this market, and the finding of market "redundancy", further confirm my earlier suspicion that there are no "market flaws" worthy of correction through bureaucratic artifices.

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[1] Indeed, today's order indicates, slip op. at 5, that nearly two years have elapsed since NEPOOL's initial commitment to file a market redesign proposal. Given NEPOOL's track record in this record, the Commission's undisguised skepticism that NEPOOL will meet even its now-extended commitment is well-founded.

In the second of today's orders (Docket Nos. ER00-971-000, ER00-996-000 and ER00-1035-000), NEPOOL and the ISO seek and receive extensions of the price caps in the Operable Capability and Operating Reserve markets. In the case of the Operable Capability market, the price cap is extended from December 31, 1999 to February 29, 2000 (the termination date of that market). In the case of the Operating Reserves market, the price cap is extended from December 31, 1999 to June 30, 2000 (or, if earlier, the date on which NEPOOL finally implements its new market design).

The Commission's rationale, slip op. at 4, in support of extension of the New England price caps is simple. It sticks to its earlier finding that the troubled markets are plagued by market "flaws". And it continues to find that price caps are necessary until that time NEPOOL or the ISO has implemented the long-awaited alternative market design. In the absence of such a market redesign, the removal of price caps, in the opinion of the Commission, "would simply expose New England ratepayers to having to pay the arbitrarily high and unreasonable prices that suppliers could demand during periods of capacity deficiency or emergency without any offsetting benefit." Id.

I find this rationale wholly unconvincing. First, I continue to believe that there are no market "flaws" that can surgically be remedied by the price cap bludgeon. I explained my thinking in this regard in detail in my dissent to the September 30, 1999 price cap order. See 88 FERC at 61,973.

I add this seasonal example. It seems that sellers of roses tend to inflate the prices of their wares – we would call these "price spikes" – during the middle of every February. But I would not malign such behavior with the vaguely sinister label of "strategic bidding" or condemn Valentine's Day rose prices as "arbitrarily high and unreasonable." And I would certainly hope that the federal government would not act to intercede to limit the prices that FTD or 1-800-FLOWERS (or the entrepreneurial sidewalk vendors on First Street) could charge for their merchandise.

Second, by giving NEPOOL and the ISO the price cap extensions they seek, the Commission is rewarding them for not making the redesign filing they have promised. I view the fault here as more ours than theirs. Once price caps are in place, I cannot blame NEPOOL and the ISO for not acting expeditiously to place into effect reforms to eradicate the flaws they have detected. They have no incentive to do so. While the Commission tries to talk tough, it really condones precisely the type of market-busting behavior it should be condemning vigorously.

For example, our earlier orders limited the price caps to the date of filing of a market redesign proposal. Now, however, the Commission extends price caps to the later date of implementation of a market redesign proposal. Moreover, the Commission's earlier price cap orders explicitly limited any further extension of price capping authority to a demonstrated showing of "need". Now, however, the only continuing "need" for price caps is that manufactured by NEPOOL and the ISO – their own inability to develop and to file the market redesign they have promised.

Third, in our orders today (and in our recent California price cap order), the Commission indicates no serious inclination to treat a “temporary” or “limited” price cap as truly “temporary” or “limited”. An ISO that is uneasy about relying on market forces knows now that it need only get its foot in the door. Short-term solutions become long-term fixtures. The Commission has demonstrated that it is not willing to make enemies, and upset newly-established bureaucracies, by keeping an ISO to its word.

(I had hoped for some of the intestinal fortitude demonstrated by the Commission in its November 23, 1999 order. In that order, the Commission rejected a proposed extension of New England Market Rule 15, which would have continued to authorize the ISO to take certain corrective actions in certain circumstances. In allowing Market Rule 15 to expire, the Commission got it right when it explained that extending the Rule yet again, after it had been in place for five months, would “simply perpetuate reliance on intervention in the NEPOOL markets.” 89 FERC at 61,639. I fail to see why the Commission, having demonstrated that it can act boldly when necessary to promote markets, is now – in near-identical circumstances – deferring so meekly to the NEPOOL and the ISO.)

Finally, and most significantly, I depart from the Commission’s stated inability to detect any “offsetting benefit”, <u>see</u> slip op. at 4, to consumers from removal of the price caps. In my opinion, New England consumers would be much better off by removing remaining price caps now. The alternative favored by the Commission, while sugar-coated to sound pro-consumer, actually harms consumers by reducing supply and eliminating options. As I previously have explained, 88 FERC at 61,973, price caps have the pernicious effect of distorting price signals and inhibiting market entry.

I continue to believe strongly that the Commission should be doing more – not less – to encourage badly-needed Capital investment in energy facilities. This concern extends not just to investment in electrical generation and transmission, but also to investment in natural gas facilities and development of hydroelectric projects. As recent headlines demonstrate, this is no academic or theoretical exercise. Residents in New England are facing an unusually harsh winter and unusually high energy prices. The problem is so severe that the Clinton Administration just this month released $125 million in federal aid to help low-income northeasterners pay for home heating fuel.

Today's orders only exacerbate existing problems. They represent a step in the wrong direction.